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SUBJECT: ATLANTIC CANADA ENERGY UPDATE: ENERGY EXPORTS TO THE U.S.
NOW A MAJOR FACTOR IN THE REGIONAL ECONOMY

REF: HALIFAX 0025 AND PREVIOUS

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INTRODUCTION/SUMMARY

1. The Atlantic Provinces Economic Council (APEC), a well-respected regional think tank, focused its latest analytical report on the importance of the energy sector in Atlantic Canada. APEC economists concluded that the sector has grown to become the most important group of industries in Atlantic Canada, spurred on by strong demand in U.S. markets, particularly in the northeast. Atlantic Canada's energy exports to the United States in 2008 were over C\$37 billion, approximately 89 percent of the region's total. The energy industry continues to make a significant contribution to the regional economy, especially in Newfoundland-Labrador where energy developments have brought about the biggest economic turnaround in Canadian history.

2. For all this activity the APEC economists also see many challenges in the months and years ahead. Of immediate concern has been the drop in demand for energy products as a result of the North American economic downturn. A more serious situation could develop if potential mega-projects are delayed or cancelled due to market conditions illustrated already by Irving's recent announcement that it was shelving its plans to build a second oil refinery in Saint John, New Brunswick. Nonetheless, there could be a silver lining ahead in that the demand for clean energy could spur growth in the region's renewable energy sector, where wind generated power is taking the lead. END INTRODUCTION/SUMMARY

3. Following are highlights of the APEC Report entitled, "Energy Production and Projects in Atlantic Canada."

Energy - Now the Region's Most Important Industry

4. Until recently, fishing and forestry were the main industries that dominated economic activity in the four provinces of Atlantic Canada: New Brunswick, Newfoundland-Labrador, Nova Scotia and Prince Edward Island. There have been sharp declines in those industries over the years due to the collapse of fish stocks, competition from low-wage countries and shifts in demand. Since the mid-1990s, energy industries have gradually taken over and have now become the dominant sector in the regional economy. For example, in 2009, energy developments in APEC's regional project inventory, including those in the proposal stage and those already underway, total nearly C\$42 billion, or approximately 55% of the total list.

The Economic Impact: A Massive Turnaround for N-L

¶5. In term of direct employment, the impact of the energy industry is actually quite small - just over 18,000 jobs or 1.6% of total employment in Atlantic Canada. However, its economic influence is much greater as 8% percent of Atlantic Canada's GDP now comes from the energy sector. Newfoundland-Labrador has seen the most drastic impact as energy now accounts for 21% of the province's GDP, compared to Nova Scotia with 4%. In fact, Newfoundland-Labrador has had the fastest growing economy in Canada since 2000, with an estimated 70% of this growth attributed to the mining and oil and gas sectors. To illustrate, Newfoundland-Labrador's GDP per capita in 2008 was C\$61,938 compared to a Canada-wide average of C\$48,106. This growth has meant that the province has gone from being the poorest province in Canada to one of the richest, representing the biggest economic turnaround in Canadian history.

Energy Exports - the Importance of the U.S. Market

¶6. In terms of exports, energy products are critically important, accounting for approximately C\$42 billion in 2008 or about 63% of the region's total merchandise exports. Of these energy exports, 89% are destined for the United States. Crude and refined oil accounts for 80% of marine tonnage into and out of seaports in the Atlantic region.

Newfoundland-Labrador Offshore Oil: Where It's All At

¶7. The overall investment trend continues to be driven by mega energy projects, those over C\$250 million, with offshore oil developments in Newfoundland-Labrador the major contributor to energy investment in Atlantic Canada. There are now three oil

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fields in production off Newfoundland-Labrador which make up 25% of Canada's crude oil and 12.5% of all oil: Hibernia (1,244 million barrels) where production will be increased and sustained by development of the Hibernia South field (223 million barrels), Terra Nova (354 million barrels) and White Rose (305 million barrels). Currently, the expansion of the White Rose project (an investment of C\$3.5 billion) and other exploration activity (C\$1.1. billion) will support growth in the Newfoundland-Labrador economy until the end of 2011, at which point construction of the province's fourth offshore oil project, Hebron, (581 million barrels when completed in 2017) is anticipated to ramp up at a total cost of C\$5 billion. There is robust exploration activity underway in Newfoundland-Labrador as well, although there is an ongoing problem with a lack of deepwater drilling rigs.

Natural Gas: Nova Scotia the Major Player

¶8. Investment in Nova Scotia's offshore natural gas sector remains strong which includes the upgrading of the existing Sable natural gas project (85 billion cubic meters) and development of the second natural gas project, Deep Panuke, (18 billion cubic meters) which will come on stream in 2010. Currently Nova Scotia produces approximately 2.5% of all natural gas in Canada. However, there are questions about the sector's long-term future. There is no active exploration underway and the last exploration well in Nova Scotia's offshore was begun in ¶2005. The result is that gas production could begin its decline by 2024 when the two projects start to wind down. Newfoundland-Labrador has significant offshore natural gas potential with an estimated 306 billion cubic meters for future development. (FYI: Exploitation of these reserves is not commercially viable at present because of harsh environmental conditions and a lack of transportation options. END FYI.) There is also a producing onshore natural gas project in New Brunswick - the McCully field - which has an estimated 9 billion

cubic meters of gas. Some is used for local consumption, some for export to the United States.

LNG: The New Guy on the Block

¶19. The Canaport LNG regassification plant in Saint John, New Brunswick, (owners are Irving Oil and Repsol of Spain) began shipping gas to the U.S. market in July 2009. The plant has a capacity of 1.2 billion cubic feet per day, equal to approximately 20% of demand in the U.S. northeast. Gas supplies are currently coming from Trinidad and Tobago but long term plans include utilizing offshore natural gas from Newfoundland-Labrador. Canaport appears to be the only LNG project that will actually reach production in the near future. There are other LNG projects under consideration in Atlantic Canada, but low prices and weak demand for natural gas have slowed the progress on these proposals. Also there is strong competition from new sources of energy such as shale gas.

Natural Gas Pipelines: New and Old

¶10. The Maritimes and Northeast Pipeline (M&NP) transports Sable natural gas from Nova Scotia's offshore to landfall in Nova Scotia, over New Brunswick and then across the U.S.-Canada border to New England. The Canadian portion has a capacity of 440 million cubic feet per day, the U.S. portion, 800 million cubic feet per day. Tied into the M&NP is the recently-completed Brunswick Pipeline which provides connectivity between the Canaport LNG plant in Saint John and the M&NP. It has a capacity of 850 million cubic feet per day.

Refineries: Expansion Stymied by Economic Forces

¶11. There are three operating refineries in Atlantic Canada: Come-by-Chance, Newfoundland-Labrador (Harvest Energy) producing 115,000 barrels per day; Dartmouth, Nova Scotia (Imperial Oil) producing 89,000 barrels per day; and, Saint John, New Brunswick (Irving Oil) with daily production of 300,000 barrels of oil per day, making it Canada's largest refinery. Up until the spring of 2009, Irving had contemplated building a second refinery at its Saint John site, but the company recently shelved the plan because of the current economic downturn in the North American economy. That development will have an immediate impact on investment in New Brunswick and comes as a major setback for those working towards making Saint John an energy hub for the northeast.

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Hydroelectricity: Labrador's potential

¶12. Newfoundland-Labrador's Upper Churchill Falls hydro project is the second largest in Canada and the ninth largest in the world, producing 5,428 MW. The province, through its energy corporation Nalcor, is now targeting the development of the Lower Churchill River which would see development of two components: Gull Island (2250 MW) and Muskrat Falls (824 MW). Construction could begin as early as late 2010 with first delivery by 2015. Nalcor's proposal is to provide a portion of the power to the Island of Newfoundland to reduce its dependence on thermal power generation. However, it would require the construction of an expensive power line across Labrador and under the Strait of Belle Island. An equally important focus will be on selling the power outside the province, which would require new transmission arrangements either through the province of Quebec or through an undersea transmission line to Nova Scotia and New Brunswick.

Renewables: Wind and Other Ideas under Consideration

¶13. While most of the region's energy success has focused on oil

and gas, a new area of interest is on the renewable energy side, spurred on by the demand for cleaner fuels and the desire for reduced emissions of greenhouse gases. Wind power in particular is highly popular in all four provinces, with nine wind farms in production and two slated to come on stream. One of the largest projects is in Prince Edward Island where the C\$220 million West Cape Wind Park will eventually produce 99 MW of power, partly for local consumption, partly for export into New England. However, several other wind projects have been delayed due to financing and profitability concerns: five in Nova Scotia and two in New Brunswick. Tidal power is also a possibility as there are sites along the shores of the Bay of Fundy in Nova Scotia and New Brunswick that appear promising. To add to the mix, there are biomass power projects under consideration.

Nuclear Power: Concern over an Expensive Refurbishment

¶14. Nuclear power is also an important component in the region's energy sector, although the delay in completing the C\$1 billion project to refurbish the Point Lepreau nuclear plant in New Brunswick is causing much concern. While not mentioned in the APEC report, the province's energy minister recently said that the project is 16 months behind schedule. The costs associated with the delay could cripple the provincially-owned utility and casts doubt on whether the province could proceed with a much-anticipated second reactor at the site. Half of the intended 1085 MW from the new reactor could replace coal and oil fired generation within New Brunswick, Nova Scotia and Prince Edward Island, so there could be an additional environmental impact should these plans be shelved.

Electrical Transmission/Energy Corridors

¶15. Transmission capacity has been recently expanded between New Brunswick and Maine with 345 kV added in 2007 to handle more electricity exports. However, additional transmission capacity will be required throughout the Atlantic region to accommodate the export of renewables especially from Prince Edward Island. Meanwhile the New Brunswick and Maine governments and Irving Oil are examining the feasibility of developing an energy corridor which would include up to 1,500 MW of electrical transmission capability, new wind power and a 500 MW natural-gas-fired co-generation plant. However, there have been no new recent developments in this project.

Future Developments: The Impact of Recessionary Forces

¶16. For all this activity, the APEC economists noted there are definite challenges surrounding future growth in the energy sector. First and foremost has been the drop in demand for energy products as the recession has taken hold, and the corresponding influence on the price of various energy products. Already there is evidence that the recession is hampering future development as illustrated by the decision to shelve a second refinery in Saint John and delay new LNG plants. APEC noted that there could be serious challenges emerging if other potential mega-projects are delayed or cancelled due to a re-evaluation of market potential. A second challenge to the industry lies in attracting and retaining highly-skilled workers. The failure to do so would have a drastic impact for

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some future developments, especially when a concentration of new project construction comes along in 2015-16.

¶17. As the economists noted there are positive signs in the industry outside the traditional oil and gas sector, the most promising coming from the need to address climate change. Ending the region's reliance on coal-fired electricity generation and a greater focus in the U.S. on renewable energy is prompting all provincial governments to look at new cleaner energy sources. This new focus could open up considerable new growth in the region's energy sector and would help in easing

some of the effects of a prolonged negative economic climate.

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